PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Item 10 **I.D.# 3285**

ENERGY DIVISION **RESOLUTION E-3832**
MARCH 16, 2004

R E S O L U T I O N

Resolution E-3832. Southern California Edison Company (SCE) requests approval of its 2001 and 2002 Performance Based Ratemaking (PBR) Performance Reports, which detail revenue sharing calculations and service quality performance rewards for 2001 and 2002. SCE's requests are approved.

By Advice Letter 1608-E-B, filed on August 18, 2003, and Advice Letter 1697-E-A filed on August 18, 2003.

SUMMARY

This resolution approves SCE's 2001 and 2002 PBR Performance Reports and associated rewards. SCE Advice Letter (AL) 1608-E-B provides SCE's report of its 2001 operational and service quality performance results under its PBR mechanism. SCE Advice Letter (AL) 1697-E-A provides SCE's report of its 2002 PBR performance results.

For 2001 and 2002, SCE reported a total reward of $25.0 million for its performance compared to the PBR service quality benchmarks. The breakdown of the performance rewards/(penalties) is as follows:

Table 1: 2001 and 2002 PBR Service Quality Performance Awards

	2001	2002
Employee Safety	$5,000,000	$5,000,000
Customer Satisfaction	$8,000,000	$2,000,000
System Reliability		
(ACMI)	$0	$0
Outage Frequency	$5,000,000	$0
Total Rewards	**$18,000,000**	**$7,000,000**

SCE reported that its 2001 PBR performance resulted in a sharing of net revenue "losses". SCE's 2001 return on equity (ROE) fell to 10.44%, from 11.53% in 2000, while SCE's authorized ROE was 11.6%. Under SCE's PBR, if the actual ROE is outside a 50 basis point "deadband" around the authorized ROE, the revenue sharing mechanism is triggered. In this case, ratepayers are sharing SCE's "loss". This is the first time that a utility operating under a Commission-approved base rate PBR has requested that ratepayers share in utility losses. SCE requests that ratepayers pay an additional $21.9 million to compensate SCE for these 2001 losses.

SCE reported that its 2002 PBR performance resulted in an ROE of 10.56%, again well below its authorized ROE of 11.6%. SCE requests that ratepayers pay an additional $18.1 million to compensate SCE for these 2002 losses.

SCE's reward and revenue sharing amounts shall be recorded in the PBR Distribution Revenue Requirement Performance Memorandum Account.

BACKGROUND

The Commission adopted SCE's PBR mechanism in Decision (D.) 96-09-092. This mechanism was originally applicable to transmission and distribution (T&D), and it was scheduled to operate until December 21, 2001. In 1998, SCE's PBR mechanism was made applicable to only the distribution component of SCE's rates.[1] On May 4, 2001 SCE filed a petition to extend and modify its PBR mechanism. In our D.01-06-038, we extended the PBR mechanism until superseded by Edison's next GRC. Then, D.02-04-055 modified the PBR mechanism until superseded by SCE's 2003 GRC. This decision adopted a methodology to establish a distribution revenue requirement for the period from June 14, 2001 to December 31, 2001 and for subsequent years. It also revised the benchmarks for employee safety, customer satisfaction, and system reliability.

SCE's PBR mechanism as established in D.96-09-092 consisted of a "rate indexing" formula, a revenue sharing mechanism for distributing gains and losses between ratepayers and shareholders, a cost of capital trigger mechanism

[1] In AL 1344-E, SCE excluded revenues and costs associated with ISO-controlled transmission facilities from its distribution rates.

to adjust the authorized ROE due to changes in interest rates, service quality measures, "z factor" allowances to cover unexpected costs, and a monitoring and evaluation program.

SCE files an advice letter annually to report its performance under the PBR mechanism. In compliance with D.96-09-092, SCE filed AL 1608-E on April 2, 2002 and AL 1697-E on March 31, 2003 to report its performance for the years 2001 and 2002, respectively. SCE subsequently filed supplemental advice letters for both PBR reports, replacing the earlier reports, to incorporate certain revisions to its reported ROE. SCE filed AL 1608-E-B and AL 1697-E-A on August 18, 2003.

In its PBR Reports, SCE notes that the revenue sharing amounts and service quality rewards will be recovered through its PBR Distribution Revenue Requirement Performance Memorandum Account. SCE's Preliminary Statement states that "Disposition of amounts in this account shall be determined in the annual Revenue Adjustment Proceeding (RAP) or other proceeding expressly authorized by the Commission."

NOTICE

Notice of ALs 1608-E-B and 1697-E-A was made by publication in the Commission's Daily Calendar. SCE states that a copy of the Advice Letter was mailed and distributed in accordance with Section III-G of General Order 96-A.

PROTESTS

Advice Letters 1608-E-B and 1697-E-A were not protested.

DISCUSSION

1. Revenue Sharing

The SCE revenue sharing mechanism distributes net revenues between ratepayers and shareholders when the actual earned ROE is above or below a "deadband" around a benchmark ROE. The Commission initially established the benchmark ROE, which may be adjusted by a cost of capital trigger mechanism. The revenue sharing mechanism consists of three bands, symmetric around the benchmark ROE.[2] Unlike the PBR adopted for San Diego Gas & Electric and Southern California Gas Company, SCE's operational revenue "losses" are subject to sharing with its ratepayers.

SCE's actual ROE for its electric distribution operations was 10.46% in 2001 and 10.59% in 2002. Both of these returns were well below SCE's authorized ROE of 11.6%.

In response to an Energy Division data request, SCE indicated that despite its efforts to reduce operation and maintenance (O&M) expenses in 2001 due to its financial distress, flat sales and higher rate base were the driving factors causing 2001 actual ROE to be lower than the authorized return.

In 2002, SCE restored many of the expenses that had been reduced in 2001, primarily on transmission and distribution spending, and this resulted in SCE not earning its authorized ROE in 2002.

The Commission has reviewed SCE's results of operations for 2001 and 2002 along with the SCE revenue sharing calculations, and concurs that ratepayer sharing of SCE losses results from SCE's 2001 and 2002 financial performance.

2. Service Quality Performance

The SCE PBR mechanism provides incentives for higher performance in the areas of employee health and safety, customer satisfaction, and electric service reliability. In AL 1608-E-B, SCE requested incentive awards of $18 million for its 2001 performance in these areas. In AL 1697-E-A, SCE requested incentive awards of $7 million for its 2002 performance in these areas.

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[2] i. The inner band covers 50 basis points around the benchmark, where shareholders receive all net revenue gains or losses.

ii. The middle band covers 50 to 300 basis points around the benchmark, where shareholders' share of marginal gains or losses (above 50 basis points) rises from 25 to 100 percent.

iii. The outer band covers 300 to 600 basis points around the benchmark, where shareholders receive all marginal gains or losses.

2.1 Employee Health and Safety

The SCE Employee Health and Safety indicator is based on the frequency of recordable Federal Occupational Safety and Health Administration (OSHA) injuries and illnesses. The OSHA frequency standard is calculated by multiplying the number of recordable incidents by 200,000 (100 employees at 2,000 hours / year) and dividing this figure by the total utility non-generation working hours during the calendar year.

For 2001, the benchmark for SCE employee health and safety was set at an OSHA frequency of 13.0, with a deadband of plus or minus 0.3. For each tenth of a point SCE scores above or below the deadband, it is penalized / rewarded $556,000, up to a maximum of $5,000,000. In 2001, SCE experienced 509 recordable incidents, resulting in an OSHA frequency of 4.6 and a maximum reward of $5,000,000.

For 2002, the benchmark was revised in D.02-04-055. For 2002, the benchmark for SCE employee health and safety was set at an OSHA frequency of 9.5, the deadband remained at 0.3, and the incentives remained at $556,000 for each tenth of a point above or below the deadband. In 2002, SCE experienced 371 recordable incidents. The OSHA frequency fell to 3.2, again resulting in a maximum reward of $5,000,000.

The Commission believes that SCE calculated its OSHA frequency for 2001 and 2002 and the $5,000,000 rewards correctly.

2.2. Customer Satisfaction

SCE’s Customer Satisfaction indicator is based on the results of a survey of customers who received certain types of customer service from SCE in the calendar year. This survey is conducted by an outside consultant. Interviews are conducted with a sample of customers receiving service over a certain year in four service areas: field service and meter reading, in-person services, telephone center operations, and service planning activities.

The Customer Satisfaction benchmark of surveyed customers indicating a “completely satisfied” or “delighted” response was set at 64% in 2001 and 69% in 2002, accompanied by a deadband of plus or minus 3%. For each percentage point SCE scores above or below the deadband, it is penalized / rewarded $2,000,000, up to a maximum of $10,000,000.

SCE reports that 71% of the customers that participated in its customer survey were "completely satisfied" or "delighted" with SCE's service in 2001, and the survey result rose to 73% in 2002. SCE's performance figures in 2001 and 2002 result in an $8 million reward in 2001 and a $2 million reward in 2002.

After reviewing SCE's Customer Satisfaction service performance, the Commission agrees that the above rewards result from SCE's 2001 and 2002 performance.

2.3 Electric System Reliability

SCE's Electric System Reliability performance is judged against two reliability indicators: Average Customer Minutes of Interruption (ACMI) and Outage Frequency.

SCE excludes outages that have a duration of more than 5 minutes of ACMI in a 24-hour period when reporting its performance under these electric reliability indicators.

2.3.1 ACMI

ACMI measures the average electric service interruption duration per customer, excluding outages that have a duration of more than 5 minutes of ACMI in a 24-hour period. Under SCE's PBR, both the ACMI benchmark and the ACMI performance results are calculated as the rolling average over two successive years. In 2001, the ACMI benchmark in the SCE PBR was 52 minutes, with a 6 minute deadband on both sides of the benchmark. A $1 million reward / penalty amount is assigned to each minute change below or above the deadband, with a maximum reward / penalty of $18 million. SCE reported an ACMI of 50 minutes in 2001, resulting in no reward or penalty.

In 2002, the ACMI benchmark declined to 51 minutes, still with a 6 minute deadband on both sides of the benchmark. A $1 million reward / penalty amount is assigned to each minute change below or above the deadband, with a maximum reward / penalty of $18 million. SCE reported an ACMI of 50 minutes in 2002, again resulting in no reward or penalty.

After reviewing SCE's 2001 and 2002 ACMI performance data, the Commission agrees that no reward or penalty is warranted for 2001 or 2002.

2.3.2 Outage Frequency

The Outage Frequency indicator measures the number of annual circuit interruptions, excluding outages that have a duration of more than 5 minutes of ACMI in a 24-hour period. In 2001, the benchmark Outage Frequency in SCE's PBR is 10,900 outages per year, with a deadband of 1100. A $1 million reward / penalty amount is assigned to roughly each 183 interruptions from the deadband, with a maximum reward / penalty of $18 million. SCE reported a two-year rolling-average Outage Frequency of 9060 interruptions for 2001, resulting in a $5 million reward.

For 2002, the Outage Frequency benchmark was 9482 interruptions, again with a deadband of 1100. The incentive rate remained at $1 million per 183 interruptions, and the maximum reward remained at $18 million. SCE reported a two-year rolling-average Outage Frequency of 9118 interruptions for 2002, resulting in no reward or penalty.

After reviewing SCE's 2001 and 2002 Outage Frequency performance data, the Commission agrees with the calculation of a $5 million reward in 2001 and no reward or penalty in 2002.

3. Other Reported Information

With ALs 1608-E-B and 1697-E-A, SCE also reports information about its cost of capital trigger mechanism, data related to distribution facility failure rates, and data provided pursuant to D.99-12-035.

4. Evaluation of SCE's Overall PBR Performance

SCE's actual ROE has been below the authorized ROE for each of the last five years, but significantly declined further in 2001 and 2002. Performance has fallen to such an extent that large "losses" will be shared with SCE's ratepayers under SCE's PBR. SCE's ratepayers will reimburse SCE in the amount of $22 million for poor financial performance in 2001 and $18 million for poor financial performance in 2002.

SCE's declining ROE has resulted from:

1) large increases in O&M expenses (Distribution O&M expenses were 40% higher in 2002 than in 1999.),
2) flat sales growth (Electric sales in 2001 and 2002 were almost unchanged from 1999.), and
3) a large increase in rate base (Rate base increased by $500 million from 1999 to 2002, a 10% increase.).

SCE's service quality performance has resulted in the following large shareholder rewards:
1998: $15 million
1999: $17 million
2000: $19 million
2001: $18 million
2002: $7 million

Until 2002, SCE's PBR was a "rate-indexed" PBR, i.e. SCE's distribution rates were directly adjusted by productivity and inflation factors. In mid-2002, the Commission revised SCE's to become a revenue requirement-indexed PBR. SCE's PBR rate adjustment formula has annually increased SCE's distribution rates by fairly modest amounts, ranging from as little as 0.27% in 1998 to as much as 1.83% in 1997. The PBR adjustment formula helps to dampen SCE rate increases below the rate of inflation because it includes a "productivity adjustment".

SCE's recent performance under its PBR has been similar to that of San Diego Gas & Electric Company (SDG&E). During the operation of its current PBR, SDG&E shareholders and ratepayers have not received sharable earnings, and SDG&E has not surpassed its authorized ROR during the years 2000-2002. SDG&E's PBR does not require ratepayers to share in losses below a deadband. In its advice letters for its 2001 and 2002 performance, Edison is requesting ratepayers to pay over $40 million to share in Edison's poor financial performance.

In addition, like SCE, SDG&E has reported large, combined PBR performance indicator rewards for its shareholders. For just the 1999 through 2002 period, SDG&E reported $40 million in shareholder quality of service incentive rewards. Similar to SDG&E's PBR performance, Edison ratepayers have benefited from certain service quality improvements, but have been paying substantial shareholder rewards for those improvements.

Southern California Gas Company (SoCalGas) has provided ratepayer revenue sharing under its PBR, and the SoCalGas PBR does not provide for shareholder service quality incentives comparable to those included in the SCE or SDG&E PBR. SoCalGas achieved an actual ROR of 9.02% in 1998, 10.13% in 1999 and 11.82% in 2000, 10.8% in 2001, and 9.99% in 2002. This performance has resulted in approximately $110 million in sharable earnings, with about $54 million of these earnings assigned to ratepayers on a grossed-up basis.

SoCalGas' ability to exceed its authorized ROR is notable because the productivity factors in its PBR update formula (2.2% in 1999, 2.3% in 2000, 2.4% in 2001, and 2.5% in 2002) are higher than the SCE productivity factors (1.6% for the years 1999 through 2002). SoCalGas has been required to achieve higher levels of productivity than SCE, yet has been able to exceed its authorized ROR. Also, SoCalGas' combined PBR performance indicator rewards total only $1,360,000 in 1998 through 2002, but SoCalGas has met or exceeded its service quality PBR benchmarks.

In summary, SCE's ratepayers have not benefited from any revenue sharing results under its current PBR from 1998 through 2002, and ratepayers have had to share in losses associated with SCE's poor financial performance in 2001-2002. SCE ratepayers have seen overall service quality improvements in certain areas, but will have paid substantial rewards for those improvements to SCE shareholders. SCE's overall PBR adjustments have not been large. Compared to SoCalGas and SDG&E, SCE's performance under its PBR is more similar to that of SDG&E. SoCalGas has been able to exceed its authorized ROR, and has had to achieve higher productivity levels than SCE. At the same time, SoCalGas meets or exceeds its performance targets, yet receives far less compensation than SCE. SCE's PBR financial performance has lagged that of SoCalGas, but SCE has reaped large performance rewards for shareholders. In addition, Edison's PBR requires ratepayers to share in financial losses relative to the authorized ROE, while neither SoCalGas' nor SDG&E's PBR provides for ratepayer sharing of losses.

COMMENTS

This is an uncontested matter in which the resolution grants the relief requested. Accordingly, pursuant to Public Utilities Code Section 311(g)(2), the otherwise applicable 30-day period for public review and comment is being waived.

FINDINGS

1. With ALs 1608-E-B and 1697-E-A, SCE filed its annual PBR performance reports for the years 2001 and 2002.
2. The revenue sharing amounts and quality of service rewards calculated in those advice letters are in compliance with D.96-09-092 and D.02-04-055.

THEREFORE IT IS ORDERED THAT:

1. Southern California Edison Advice Letters 1608-E-B and 1697-E-A are approved with an effective date of today.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on March 16, 2004; the following Commissioners voting favorably thereon:

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WESLEY M. FRANKLIN
Executive Director